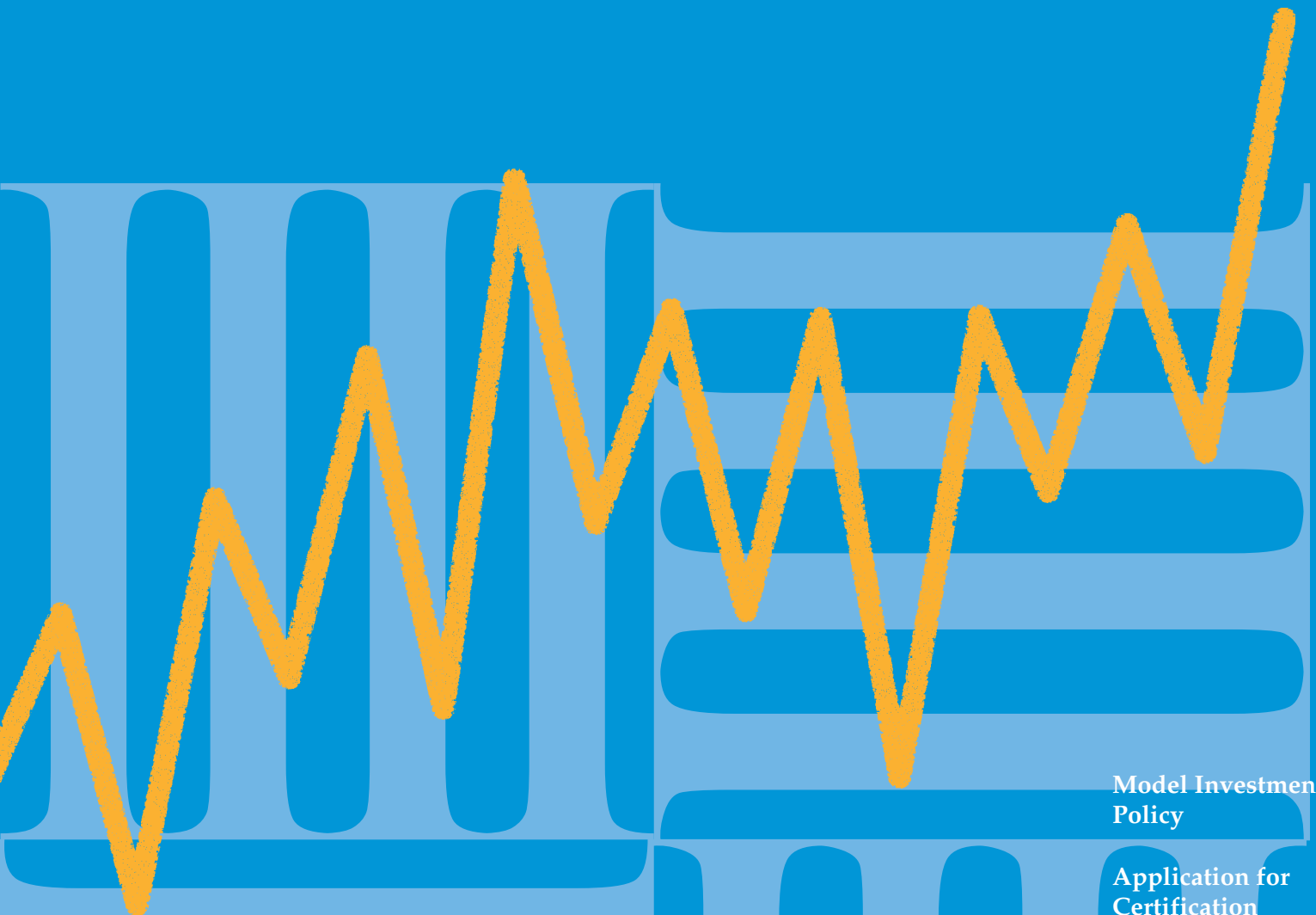


MTA US & C

Investment Policy Certification Program



Model Investment
Policy

Application for
Certification

Glossary of Terms

Guidelines for an
Investment
Procedures Manual

Municipal Treasurers'
Association of the
United States &
Canada

Dear Applicant:

Thank you for your interest in MTA US&C's Investment Policy Certification Program.

The Investment Policy Certification Program provides professional guidance and assistance in developing or improving existing investment policies in the public sector. Entities may request the Investment Policy Certification Committee to review their policy to determine if they have met the standards set forth by the Association. Those jurisdictions who comply with MTA US&C's criteria are presented with the Association's Written Investment Policy Certification.

Enclosed please find the necessary documents to apply for MTA US&C's Written Investment Policy Certification — Application Form and MTA US&C Model Investment Policy.

The application form along with specified documentation must be completed and forwarded directly to MTA US&C. The information solicited will assist the assigned reviewers in analyzing your investment policy.

Program Procedures

1. Submit five copies of the application form and appropriate documentation to MTA US&C. The program fee is \$175 for MTA US&C members (\$275 for non-members). If the first submission is unsuccessful, the application fee will be waived for a second submission. Resubmissions must be made by June 1st of the following year.
2. The submitted investment policy documentation will be forwarded to three reviewers who will evaluate the investment policy and make a recommendation as to certification. Two out of three members must vote in favor of awarding certification in order for the entity to receive MTA US&C's Written Investment Policy Certification. To assist the reviewers, please enclose five copies of your investment policy, including your glossary.
3. Approximately six weeks after receipt of submission, notification of certification will be mailed to the individual identified on the application form (Item 15) as well as the treasurer requesting the review. Comments from the reviewers will be forwarded to both successful and unsuccessful applicants.
4. Investment Policy review and certification occur continually throughout the year. However, investment policies must be submitted by June 1st in order for successful applicants and entities to receive recognition and a plaque at MTA US&C's annual conference in August.

Should you have any questions about the application or the model investment policy, please contact Jeff Cyphert, Investment Policy Certification Chair at (810) 694-5300. We appreciate your comments or suggestions relating to this certification program.

Stacey Crane
Executive Director

Application Form for a Written Investment Policy Certification

Please return this application form along with the program fee of \$175 (\$275 for non-members) to MTA US&C, Investment Policy Certification Program, 1029 Vermont Avenue, NW, Suite 710, Washington, DC 20005. Enclose **five copies of the application form and five copies of your investment policy.**

1. **Name of government:** (as it will appear on your plaque)

Mailing Address: _____

2. Population of government/size of district/retirement system: _____

3. Size of total investment portfolio: _____

4. Indicate below the composition of the current portfolio:

| | | | |
|--------------|----------|-------|----------|
| Treasuries | \$ _____ | CD's | \$ _____ |
| Agencies | \$ _____ | BA's | \$ _____ |
| Govt. Pool | \$ _____ | Repos | \$ _____ |
| Mutual Funds | \$ _____ | Other | \$ _____ |

5. What is the average maturity of your investment portfolio? _____ days

6. Are you a member of MTA US&C? yes _____ no _____

7. Has your investment policy been adopted by the appropriate legislative body?

yes _____ no _____

(Not required prior to submission)

8. Does your state/province or jurisdiction specifically mandate the adoption of an investment policy?

State/Province yes _____ no _____

Jurisdiction yes _____ no _____

9. Does your state/province specifically outline types of authorized investments?

yes _____ no _____

(If yes, attach five copies of the legislation or a typed summary of types of authorized investments).

10. Does your entity have a separate investment procedure manual? yes _____ no _____

(It is not required that you send your procedure manual.)

11. List investment staff by title and telephone number:

| | |
|-------|-------|
| _____ | _____ |
| _____ | _____ |
| _____ | _____ |

12. If you invest in repurchase agreements, does your entity have a signed **Master Repurchase Agreement**? yes_____ no_____ n/a_____

13. Do you employ an active or passive approach to investing?

Active_____ Passive_____

14. Treasurer requesting review:

Name: _____

Title: _____

Address: _____

Phone number: _____

15. In addition to the Treasurer requesting review (item 14), who should the formal announcement of the awarding of the **Written Investment Policy Certification** be addressed to?

Name: _____

Title: _____

Address: _____

16. Have you enclosed five copies of the following documents?

- **Application Form**
- **Investment Policy**
- **Glossary**
- **State/Province Statutes Listing Authorized Investments**

17. Date submitted_____

The MTA US&C Model Investment Policy is intended to provide guidance in the formulation of a structure to govern the investment of public funds. It must be implemented in conjunction with a careful reading of and strict adherence to applicable statutes, judicial decisions and legal opinions. It is not a guarantee against loss due to economic and market conditions or human behavior.

MTA use only:

| | | | |
|----------------------|-------|-------------|-------|
| Date Received | _____ | Reviewers | _____ |
| Check # | _____ | | _____ |
| Amount | _____ | | _____ |
| Date Sent for Review | _____ | Result/Date | _____ |

MUNICIPAL TREASURERS' ASSOCIATION
OF THE UNITED STATES AND CANADA

Model Investment Policy

For permission to reprint the Model Investment Policy, call the MTA US&C at (202) 737-0660.

1.0 **Policy:** (*maximum points: 4*)

SAMPLE LANGUAGE:

It is the policy of the (entity) to invest public funds in a manner which will provide the highest investment return with the maximum security while meeting the daily cash flow demands of the entity and conforming to all state/province and local statutes governing the investment of public funds.

2.0 **Scope:** (*maximum points: 7*)

Rationale:

**An investment policy should explain its scope. Does the policy apply to all funds held in the custody of the government jurisdiction and all of its offices?*

SAMPLE LANGUAGE:

This investment policy applies to all financial assets of the (entity). These funds are accounted for in the (entity's) **Comprehensive Annual Financial Report and include:**

2.1 Funds: (*Specifically designate. Following is a sample list.*)

2.1.1 General Fund

2.1.2 Special Revenue Funds

2.1.3 Capital Project Funds

2.1.4 Enterprise Funds

2.1.5 Trust and Agency Funds

2.1.6 Retirement/Pension Funds

2.1.7 (*Any new fund created by the legislative body, unless specifically exempted.*)

3.0 **Prudence:** (*maximum points: 4*)

Rationale:

**To burden a conscientious professional with personal responsibility for a default on a single item within a diversified portfolio seems unduly severe. (Accordingly, public entities with portfolios of sufficient size are urged to apply the prudence concept to the overall portfolio.) Following is the prudent person standard:*

SAMPLE LANGUAGE:

Investments shall be made with judgment and care—under circumstances then prevailing—which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived.

3.1 The standard of prudence to be used by investment officials shall be the “**prudent person**” standard and shall be applied in the context of managing an overall portfolio. Investment officers acting in accordance with written procedures and the investment policy and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided deviations from expectations are reported in a timely fashion and appropriate action is taken to control adverse developments.

4.0 **Objective:** (*maximum points: 10*)

Rationale:

**Every investment policy should contain a concise and clear statement(s) of objectives. The effectiveness of the investment program is set by the caliber of the staff, the procedures used, the working environment and the policy guidance provided by governing officials. Through its*

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statement of objectives, the governing body sets the tone and direction of the policy and investment program.

SAMPLE LANGUAGE:

The primary objectives, in priority order, of the (*entity's*) investment activities shall be:

4.1 **Safety:** Safety of principal is the foremost objective of the investment program. Investments of the (*entity*) shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. To attain this objective, **diversification** is required in order that potential losses on individual securities do not exceed the income generated from the remainder of the portfolio.

4.2 **Liquidity:** The (*entity's*) investment portfolio will remain sufficiently liquid to enable the (*entity*) to meet all operating requirements which might be reasonably anticipated.

4.3 **Return on Investments:** The (*entity's*) investment portfolio shall be designed with the objective of attaining a rate of return throughout budgetary and economic cycles, commensurate with the (*entity's*) investment risk constraints and the cash flow characteristics of the portfolio.

5.0 **Delegation of Authority:** (*maximum points: 4*)

Rationale:

**After the investment objectives have been identified, the next logical element of an investment policy is an explicit delegation of authority to investment officials responsible for conducting transactions and managing the entity's investment program.*

SAMPLE LANGUAGE:

Authority to manage the (*entity's*) investment program is derived from the following: (*e.g., trading resolutions, code citations, ordinances, statutes, etc.*). Management responsibility for the investment program is hereby delegated to the (*designated official*) who shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials.

***5.1 **Investment Procedures:** (*maximum points: 4*)

The (*designated official*) shall establish written investment policy procedures for the operation of the investment program consistent with this policy. The procedures should include reference to: safekeeping, PSA repurchase agreements, wire transfer agreements, banking service contracts and collateral/depository agreements. Such procedures shall include explicit delegation of authority to persons responsible for investment transactions. No person may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the (*designated official*).

See appendix to MTA US&C's Model Investment Policy entitled MTA US&C's Guidelines for an Investment Procedures Manual, adopted in November 1997.

6.0 **Ethics and Conflicts of Interest:** (*maximum points: 4*)

Rationale:

**Some governments have adopted conflict-of-interest legislation that regulates the activities of certain officers and employees. In the investment area, certain conflicts may be governed by general code provisions, so separate policies may be redundant. Some jurisdictions, however, may seek to adopt policies regarding ethical behavior and conflicts of interest.*

SAMPLE LANGUAGE:

Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair their ability to make impartial investment decisions. Employees and investment officials shall disclose to the (*Chief Executive Officer*) any material financial interests in financial institutions that conduct business within their jurisdiction, and they shall further disclose any large personal financial/investment positions that could be related to the performance of the (*entity*).

7.0 Authorized Financial Dealers and Institutions: (maximum points: 7)

Rationale:

**The investment policy should require that a set formal process be used to select depositories and brokers/dealers in money market instruments. Because the policy is intended to endure, it should not mention specific firms or depositories. Rather, it should provide for a process that will screen out institutions that lack economic viability or whose past practices suggest that the safety of public capital would be impaired if transactions were directed to or through such firms.*

SAMPLE LANGUAGE:

The Treasurer will maintain a list of financial institutions authorized to provide investment services. In addition, a list will also be maintained of approved security broker/dealers selected by credit worthiness who are authorized to provide investment services in the State/Province of (_____). These may include “primary” dealers or regional dealers that qualify under **Securities & Exchange Commission Rule 15C3-1 (uniform net capital rule)**. No public deposit shall be made except in a qualified public depository as established by state/province laws. All financial institutions and broker/dealers who desire to become qualified bidders for investment transactions must supply the treasurer with the following: *(e.g. audited financial statements, proof of National Association of Security Dealers certification, trading resolution, proof of state/province registration, completed broker/dealer questionnaire, certification of having read entity’s investment policy and depository contracts.)*

An annual review of the financial condition and registrations of qualified bidders will be conducted by the Treasurer.

A current audited financial statement is required to be on file for each financial institution and broker/dealer in which the (entity) invests.

8.0 Authorized & Suitable Investments: (maximum points: 10)

Rationale:

**The selection of investment instruments to be allowed for investment purposes is a significant policy issue for many governments. Although day-to-day selection of specific instruments should be treated as a management function, the policy should define the general universe.*

From the governing body perspective, special care must be taken to ensure that the list of instruments includes only those allowed by law and those that local investment managers are trained and competent to handle.

SAMPLE LANGUAGE:

The (entity) is empowered by statute to invest in the following types of securities.
(List types of investments authorized by state/province law, ordinance, or charter. Consider appending copies of these specific requirements to the investment policy.)

(In selecting authorized investments, consideration should be given to credit ratings on commercial paper, bankers acceptance, and collateralization of applicable instruments)

*****8.1 Master Repurchase Agreement: (maximum points: 10)**

If repurchase agreements are legal or authorized, a **Master Repurchase Agreement** must be signed with the bank or dealer.

9.0 Investment Pools/Mutual Funds: (maximum points: 7)

Rationale:

***Governmental sponsored pools and money market mutual funds are excellent short-term cash management facilities. These pools/funds can provide safety, liquidity and yield in a single investment instrument. However, there is a due diligence standard which applies to the use of pools/funds, as there is no safety net.*

MODEL INVESTMENT POLICY

If governmental sponsored pools and/or mutual funds are included in **Authorized Investments**, a section on investigation and due diligence must be included.

SAMPLE LANGUAGE:

A thorough investigation of the pool/fund is required prior to investing, and on a continual basis. There shall be a questionnaire developed which will answer the following general questions:

- A description of eligible investment securities, and a written statement of investment policy and objectives.
- A description of interest calculations and how it is distributed, and how gains and losses are treated.
- A description of how the securities are safeguarded (including the settlement processes), and how often the securities are priced and the program audited.
- A description of who may invest in the program, how often, what size deposit and withdrawal are allowed.
- A schedule for receiving statements and portfolio listings.
- Are reserves, retained earnings, etc. utilized by the pool/fund?
- A fee schedule, and when and how is it assessed.
- Is the pool/fund eligible for bond proceeds and/or will it accept such proceeds?

NOTE: *The topics listed above are not all encompassing, but only a sampling of what might be covered in a questionnaire. MTA USEC will be developing a questionnaire in the near future for use when pools/funds are part of the list of Authorized Investments.*

11.0 Collateralization: (maximum points: 7)

Rationale:

**Several states require collateralization of all public funds. In these states a collateralization section must be included for any certificates of deposit. In addition, collateralization must be required on any repurchase agreement or reverse repurchase agreement. For both of these items, the policy should address such points as market*

valuation responsibility and timing, safekeeping by a third party, and evidence of ownership.

SAMPLE LANGUAGE:

Collateralization will be required on two types of investments: certificates of deposit and repurchase (and reverse) agreements. In order to anticipate market changes and provide a level of security for all funds, the collateralization level will be (102%) of market value of principal and accrued interest.

The entity chooses to limit collateral to the following: —(list)—

Collateral will always be held by an independent third party with whom the entity has a current custodial agreement. A clearly marked evidence of ownership (safekeeping receipt) must be supplied to the entity and retained.

The right of collateral substitution is granted.

11.0 Safekeeping and Custody: (maximum points: 10)

Rationale:

**Like private investors, governing officials feel more secure about their entity's investments if they know that the securities are physically safe. Investment policies should include a clause regarding third-party safekeeping and custody of securities and collateral.*

SAMPLE LANGUAGE:

All security transactions, including collateral for repurchase agreements, entered into by the (entity) shall be conducted on a **delivery-versus-payment (DVP)** basis. Securities will be held by a third party custodian designated by the Treasurer and evidenced by safekeeping receipts.

12.0 Diversification: (maximum points: 7)

Rationale:

**...governments should state the purpose of diversification—to reduce overall portfolio risks while attaining market average rates of return. Diversification should be conceptualized in terms of maturity as well as instrument type and issuer. Thus, the diversification concept in a cash*

management fund should include prohibition against over concentration in a specific maturity sector, as well as constraining the reliance on specific risky instruments and issuers.

SAMPLE LANGUAGE:

The (entity) will diversify its investments by security type and institution. With the exception of U.S. Treasury securities and authorized pools, no more than 50% of the (entity's) total investment portfolio will be invested in a single security type or with a single financial institution.

13.0 Maximum Maturities:
(maximum points: 7)

Rationale

**To protect public funds from market price losses resulting from rising interest rates, some states and many local governments limit the maximum term to maturity on current operating funds' investments, some limit the maximum term to maturity to current operating funds' investments. Some limit the maximum maturity on cash management funds to 12 months. Others find this unduly restrictive and employ a two-year rule. The latter seems reasonable, provided that only a portion of the assets is invested beyond one year.*

SAMPLE LANGUAGE:

To the extent possible, the (entity) will attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow, the (entity) will not directly invest in securities maturing more than (____) years from the date of purchase. However, the (entity) may collateralize its repurchase agreements using longer-dated investments not to exceed (____) years to maturity.

Reserve funds may be invested in securities exceeding (____) years if the maturity of such investments is made to coincide as nearly as practicable with the expected use of the funds.

14.0 Internal Control:
(maximum points: 4)

Rationale:

**The development of internal controls remains a management function. A statement of investment*

policy therefore should avoid specific internal control measures. Instead, policy makers should require that a system of internal controls be established. The policy can also provide for periodic reviews and monitoring of the controls. The review of internal controls might be assigned to a committee or to the independent auditor.

SAMPLE LANGUAGE:

The Treasurer shall establish an annual process of independent review by an external auditor. This review will provide internal control by assuring compliance with policies and procedures.

15.0 Performance Standards:
(maximum points: 4)

Rationale:

**Much of the investment policy focus is directed toward control. Yield objectives are just as important, however. The long-run interests of the jurisdiction go beyond simple prudence and safety of funds. The investment policy should provide a formal evaluation of performance and occasional operational audits.*

SAMPLE LANGUAGE:

The investment portfolio shall be designed with the objective of obtaining a rate of return throughout budgetary and economic cycles, commensurate with the investment risk constraints and the cash flow needs.

15.1 Market Yield (Benchmark): The entity's investment strategy is (*passive or active*). Given this strategy, the basis used by the Treasurer to determine whether market yields are being achieved shall be the (*e.g. six-month U.S. Treasury Bill and the average Fed Funds rate*).

16.0 Reporting: (maximum points: 10)

Rationale:

***Periodic required investment reports to policymakers and elected officials provide necessary written communication regarding investment performance, risk analysis, adherence to policy provisions, as well as other information.*

SAMPLE LANGUAGE:

The Treasurer shall provide (*the governing body*) quarterly investment reports which provide a clear picture of the status of the current investment

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portfolio. The management report should include comments on the fixed income markets and economic conditions, discussions regarding restrictions on percentage of investment by categories, possible changes in the portfolio structure going forward and thoughts on investment strategies.

Schedules in the quarterly report should include the following:

- A listing of individual securities held at the end of the reporting period by authorized investment category
- Average life and final maturity of all investments listed
- Coupon, discount or earnings rate
- Par value, Amortized Book Value and Market Value
- Percentage of the Portfolio represented by each investment category

NOTE: Depending on the degree of comprehension of those receiving the reports and their desire, or lack thereof, for detail, you may choose to provide the information in executive summary format.

17.0 **Investment Policy Adoption:** (maximum points: 4)

The (*entity's*) investment policy shall be adopted by resolution of the (*entity's*) legislative authority. The policy shall be reviewed annually by the (*legislative authority*) and any modifications made thereto must be approved by the (*legislative authority*).

***18.0 **Glossary:** (maximum points: 4)

*Because this policy is to be available to the public as well as the governing body, it is important that a glossary of related terminology be part of the policy.

**Rationale: Adapted from Investing Public Funds, Girard Miller, 1986*

***Section 9.0 — Investment Pools New section added 11/95.*

***Section 16.0 — Reporting Section revised 11/95.*

*** *Section 5.1 — Investment Procedures Section revised 10/98.*

*** *Section 8.1 — Master Repurchase Agreement Section revised 10/98.*

*** *Section 18.0 — Glossary Section added 10/98.*

*** *Appendix - Guidelines for an Investment Procedures Manual Appendix added 10/98*

GLOSSARY

(**Note:** Entities are encouraged to include a glossary as part of the investment policy. All words of a technical nature should be included. Following is an example of common treasury terminology.)

AGENCIES: Federal agency securities and/or Government-sponsored enterprises.

ASKED: The price at which securities are offered.

BANKERS' ACCEPTANCE (BA): A draft or bill or exchange accepted by a bank or trust company. The accepting institution guarantees payment of the bill, as well as the issuer.

BID: The price offered by a buyer of securities. (When you are selling securities, you ask for a bid.) See Offer.

BROKER: A broker brings buyers and sellers together for a commission.

CERTIFICATE OF DEPOSIT (CD): A time deposit with a specific maturity evidenced by a certificate. Large-denomination CD's are typically negotiable.

COLLATERAL: Securities, evidence of deposit or other property which a borrower pledges to secure repayment of a loan. Also refers to securities pledged by a bank to secure deposits of public monies.

COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR): The official annual report for the _____. It includes five combined statements for each individual fund and account group prepared in conformity with GAAP. It also includes supporting schedules necessary to demonstrate compliance with finance-related legal and contractual provisions, extensive introductory material, and a detailed Statistical Section.

COUPON: (a) The annual rate of interest that a bond's issuer promises to pay the bondholder on the bond's face value. (b) A certificate attached to a bond evidencing interest due on a payment date. **DEALER:** A dealer, as opposed to a broker, acts as a principal in all transactions, buying and selling for his own account.

DEBENTURE: A bond secured only by the general credit of the issuer.

DELIVERY VERSUS PAYMENT: There are two methods of delivery of securities: delivery versus payment and delivery versus receipt. Delivery versus payment is delivery of securities with an exchange of money for the securities. Delivery versus receipt is delivery of securities with an exchange of a signed receipt for the securities.

DERIVATIVES: (1) Financial instruments whose return profile is linked to, or derived from, the movement of one or more underlying index or security, and may include a leveraging factor, or (2) financial contracts based upon notional amounts whose value is derived from an underlying index or security (interest rates, foreign exchange rates, equities or commodities).

DISCOUNT: The difference between the cost price of a security and its maturity when quoted at lower than face value. A security selling below original offering price shortly after sale also is considered to be at a discount.

DISCOUNT SECURITIES: Non-interest bearing money market instruments that are issued at a discount and redeemed at maturity for full face value, *e.g.*, U.S. Treasury Bills.

DIVERSIFICATION: Dividing investment funds among a variety of securities offering independent returns.

FEDERAL CREDIT AGENCIES: Agencies of the Federal government set up to supply credit to various classes of institutions and individuals, *e.g.*, S&L's, small business firms, students, farmers, farm cooperatives, and exporters.

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC): A federal agency that insures bank deposits, currently up to \$100,000 per deposit.

FEDERAL FUNDS RATE: The rate of interest at which Fed funds are traded. This rate is currently pegged by the Federal Reserve through open-market operations.

FEDERAL HOME LOAN BANKS (FHLB): Government sponsored wholesale banks (currently 12 regional banks) which lend funds and provide correspondent banking services to member commercial banks, thrift institutions, credit unions and insurance companies. The

GLOSSARY

mission of the FHLBs is to liquefy the housing related assets of its members who must purchase stock in their district Bank.

FEDERAL NATIONAL MORTGAGE ASSOCIATION

(FNMA): FNMA, like GNMA was chartered under the Federal National Mortgage Association Act in 1938. FNMA is a federal corporation working under the auspices of the Department of Housing and Urban Development (HUD). It is the largest single provider of residential mortgage funds in the United States. Fannie Mae, as the corporation is called, is a private stockholder-owned corporation. The corporation's purchases include a variety of adjustable mortgages and second loans, in addition to fixed-rate mortgages. FNMA's securities are also highly liquid and are widely accepted. FNMA assumes and guarantees that all security holders will receive timely payment of principal and interest.

FEDERAL OPEN MARKET COMMITTEE (FOMC):

Consists of seven members of the Federal Reserve Board and five of the twelve Federal Reserve Bank Presidents. The President of the New York Federal Reserve Bank is a permanent member, while the other Presidents serve on a rotating basis. The Committee periodically meets to set Federal Reserve guidelines regarding purchases and sales of Government Securities in the open market as a means of influencing the volume of bank credit and money.

FEDERAL RESERVE SYSTEM: The central bank of the United States created by Congress and consisting of a seven member Board of Governors in Washington, D.C., 12 regional banks and about 5,700 commercial banks that are members of the system.

GOVERNMENT NATIONAL MORTGAGE ASSOCIATION (GNMA or Ginnie Mae):

Securities influencing the volume of bank credit guaranteed by GNMA and issued by mortgage bankers, commercial banks, savings and loan associations, and other institutions. Security holder is protected by full faith and credit of the U.S. Government. Ginnie Mae securities are backed by the FHA, VA or FmHA mortgages. The term "pass-throughs" is often used to describe Ginnie Maes.

LIQUIDITY: A liquid asset is one that can be converted easily and rapidly into cash without a

substantial loss of value. In the money market, a security is said to be liquid if the spread between bid and asked prices is narrow and reasonable size can be done at those quotes.

LOCAL GOVERNMENT INVESTMENT POOL

(LGIP): The aggregate of all funds from political subdivisions that are placed in the custody of the State Treasurer for investment and reinvestment.

MARKET VALUE: The price at which a security is trading and could presumably be purchased or sold.

MASTER REPURCHASE AGREEMENT: A written contract covering all future transactions between the parties to repurchase—reverse repurchase agreements that establishes each party's rights in the transactions. A master agreement will often specify, among other things, the right of the buyer-lender to liquidate the underlying securities in the event of default by the seller-borrower.

MATURITY: The date upon which the principal or stated value of an investment becomes due and payable.

MONEY MARKET: The market in which short-term debt instruments (bills, commercial paper, bankers' acceptances, etc.) are issued and traded.

OFFER: The price asked by a seller of securities. (When you are buying securities, you ask for an offer.) See Asked and Bid.

OPEN MARKET OPERATIONS: Purchases and sales of government and certain other securities in the open market by the New York Federal Reserve Bank as directed by the FOMC in order to influence the volume of money and credit in the economy. Purchases inject reserves into the bank system and stimulate growth of money and credit; sales have the opposite effect. Open market operations are the Federal Reserve's most important and most flexible monetary policy tool.

PORTFOLIO: Collection of securities held by an investor.

PRIMARY DEALER: A group of government securities dealers who submit daily reports of market activity and positions and monthly financial statements to the Federal Reserve Bank of New York and are subject to its informal

oversight. Primary dealers include Securities and Exchange Commission (SEC)-registered securities broker-dealers, banks, and a few unregulated firms.

PRUDENT PERSON RULE: An investment standard. In some states the law requires that a fiduciary, such as a trustee, may invest money only in a list of securities selected by the custody state—the so-called legal list. In other states the trustee may invest in a security if it is one which would be bought by a prudent person of discretion and intelligence who is seeking a reasonable income and preservation of capital.

QUALIFIED PUBLIC DEPOSITORIES: A financial institution which does not claim exemption from the payment of any sales or compensating use or ad valorem taxes under the laws of this state, which has segregated for the benefit of the commission eligible collateral having a value of not less than its maximum liability and which has been approved by the Public Deposit Protection Commission to hold public deposits.

RATE OF RETURN: The yield obtainable on a security based on its purchase price or its current market price. This may be the amortized yield to maturity on a bond the current income return.

REPURCHASE AGREEMENT (RP OR REPO): A holder of securities sells these securities to an investor with an agreement to repurchase them at a fixed price on a fixed date. The security “buyer” in effect lends the “seller” money for the period of the agreement, and the terms of the agreement are structured to compensate him for this. Dealers use RP extensively to finance their positions. Exception: When the Fed is said to be doing RP, it is lending money, that is, increasing bank reserves.

SAFEKEEPING: A service to customers rendered by banks for a fee whereby securities and valuables of all types and descriptions are held in the bank’s vaults for protection.

SECONDARY MARKET: A market made for the purchase and sale of outstanding issues following the initial distribution.

SECURITIES & EXCHANGE COMMISSION: Agency created by Congress to protect investors in securities transactions by administering securities legislation.

SEC RULE 15C3-1: See Uniform Net Capital Rule.

STRUCTURED NOTES: Notes issued by Government Sponsored Enterprises (FHLB, FNMA, SLMA, etc.) and Corporations which have imbedded options (e.g., call features, step-up coupons, floating rate coupons, derivative-based returns) into their debt structure. Their market performance is impacted by the fluctuation of interest rates, the volatility of the imbedded options and shifts in the shape of the yield curve.

TREASURY BILLS: A non-interest bearing discount security issued by the U.S. Treasury to finance the national debt. Most bills are issued to mature in three months, six months, or one year.

TREASURY BONDS: Long-term coupon-bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having initial maturities of more than 10 years.

TREASURY NOTES: Medium-term coupon-bearing U.S. Treasury securities issued as direct obligations of the U.S. Government and having initial maturities from two to 10 years.

UNIFORM NET CAPITAL RULE: Securities and Exchange Commission requirement that member firms as well as nonmember broker-dealers in securities maintain a maximum ratio of indebtedness to liquid capital of 15 to 1; also called net capital rule and net capital ratio. Indebtedness covers all money owed to a firm, including margin loans and commitments to purchase securities, one reason new public issues are spread among members of underwriting syndicates. Liquid capital includes cash and assets easily converted into cash.

YIELD: The rate of annual income return on an investment, expressed as a percentage. (a) **INCOME YIELD** is obtained by dividing the current dollar income by the current market price for the security. (b) **NET YIELD** or **YIELD TO MATURITY** is the current income yield minus any premium above par or plus any discount from par in purchase price, with the adjustment spread over the period from the date of purchase to the date of maturity of the bond.

Appendix

****Guidelines for an Investment Procedures Manual*

For permission to reprint the *Guidelines*, call MTA US&C at (202) 737-0660.

1. **Purpose**

The purpose of these guidelines is to help create a Procedures Manual to assist Treasury staff with day-to-day investment operations. As each jurisdiction's investment operations are unique, these guidelines are an outline, with individual items to be added or deleted as necessary or appropriate.

Numerical references and subjects at the beginning of each Section refer to elements in MTA's Model Investment Policy.

2. **Cash Review**

1.0 *Policy*

5.0 *Delegation of Authority*

2.0 *Scope*

The Treasurer or his/her delegate (hereafter referred to as Investment Officer) must review the cash balances and investment portfolio daily, or as needed. Items to be reviewed should include:

- a) Balances, by fund if so deposited, at primary bank.
- b) Balances, by fund if so deposited, at other banks.
- c) Maturing investments (includes Repo's, CD's, Commercial Paper, Bankers' Acceptances and general securities).
- d) Bond sales and other large, periodic receipts.
- e) Bond and coupon payments (debt service) and other large periodic cash disbursements.

3. **Investment Selection**

3.0 *Prudence*

12.0 *Diversification*

4.0 *Objective*

13.0 *Maximum Maturities*

8.0 *Authorized & Suitable Investments*

The Investment Officer determines how much of the cash balance is available for investment and selects the area of the yield curve that most closely matches the required maturity date.

In determining the maturity date, the Investment Officer should consider liquidity, cash flow and expected expenditures. A review of some of the following sources should be made to determine whether the investments should be placed to match projected expenditures or shorter, or to take advantage of current and expected interest rate environments:

APPENDIX

- a) Wall Street Journal or similar daily business publication.
- b) Input from approved broker/dealers.
- c) Input from depository banks.
- d) Publications on general trends of economic statistics.
- e) Input from data services (Telerate, Bloomberg, Reuters, etc.)

4. Purchasing an Investment

| | | | |
|------|---|------|------------------------------------|
| 7.0 | <i>Authorized Financial Dealers</i> | 11.0 | <i>Safekeeping & Custody</i> |
| 8.0 | <i>Authorized & Suitable</i> | 12.0 | <i>Diversification Investments</i> |
| 9.0 | <i>Investment Pools</i> | 13.0 | <i>Maximum Maturities</i> |
| 10.0 | <i>Collateralization & Institutions</i> | | |

Establish with whom the jurisdiction is going to transact business. This should be accomplished through the use of a questionnaire, which helps provide the following evaluation:

- a) Financial condition, strength and capability to fulfill commitments.
- b) Overall reputation with other dealers and investors.
- c) Regulatory status of the broker/dealer (providers).
- d) Background and expertise of the individual representative.

Financial (banking) institutions should be selected through the use of a “Request for Proposal (RFP).” The use of a nationally recognized financial institution rating organization (Lace, Sheshunoff, Thompson Bankwatch, etc.) will assist in the evaluation.

Contact an appropriate number of institutions, as specified by policy. The Investment Officer should be as specific as possible in requesting the offering. If a particular type of investment or a particular issuing agency is to be excluded due to policy limitations, that should be stated to the providers. If collateral is required (i.e. for Repo’s or CD’s), the collateral limitations (excess margin, types of securities, maximum maturity, etc.) should be specified.

The following must be determined *prior* to contacting the providers:

- a) Settlement — cash, regular (next day), corporate (3 business days) or when-issued if a new issue.
- b) Amount — either par value or total dollars to be invested.
- c) Type of security to be purchased, or type to be excluded.
- d) Targeted maturity, or maturity range.
- e) Time limit to show offering — 5 minutes, 15 minutes, etc.

If choosing an external pool or fund as the preferred investment vehicle, the following should be available for inspection prior to purchase and at any reasonable time thereafter:

- a) A written investment policy, if a government-run investment pool.
- b) A prospectus for money-market funds, mutual funds or bank-managed funds.

- c) A schedule of the types of reports and the frequency of distribution.
- d) A clear description of how interest rates are calculated (30/360, actual/365, etc.)
- e) A schedule of when and how income is distributed.
- f) Are the pool or fund types of investments restricted to your own legal and policy limits?
- g) Are the pool or fund investments restricted to your own maturity limits?

Before concluding the transaction, the Investment Officer should validate the following:

- a) The security selected for purchase meets all criteria, including portfolio diversification, collateralization (if appropriate) and maturity. If the security has any imbedded options such as call provisions or coupon adjustments, these should also be reviewed.
- b) Yield calculations should be verified.
- c) Total purchase cost (including accrued interest) does not exceed funds available for investment.
- d) Advise the successful provider that their offering has been selected for purchase.
- e) After confirmation of the purchase, as a courtesy, notify the other broker/dealers that you have placed the investment. Best price may be disclosed, if you choose.

After consummation of the transaction, and prior to settlement date, the Investment Officer and the provider should exchange and review the following information to ensure prompt, and uninterrupted settlement:

- a) Name of third-party safekeeping agent.
- b) ABA number of safekeeping agent.
- c) Safekeeping account number.
- d) Reconfirm amount of transaction.
- e) Reconfirm settlement date.
- f) Acquire CUSIP number of security, if applicable.

5. Settlement & Follow-through

5.0 Delegation of Authority

6.0 The Investment Officer should forward to the safekeeping agent a report of the investment transaction. The report may be verbal, but a written form should be sent and acknowledged. When applicable, the following should be verified:

- a) Provision of receipt or disbursement of funds.
- b) Internal transfer or wiring of funds.
- c) Validation of written "safekeeping receipt".
- d) Notification of discrepancy prior to acceptance or rejection of the transaction.
- e) Immediate notification if a fail has occurred: by provider if they are responsible, by safekeeping agent if they are responsible.